

Colorado Fiscal Managers' Association

## CFMA 2007-2008 Officers

Tom Kingsolver - President

Lynn Gabenski - Vice  
President

Kelli Cheshire - Secretary

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E-MAIL ADDRESS FOR THE  
OFFICERS AND COMMITTEE  
CHAIRS CAN BE FOUND ON THE  
CFMA WEBSITE:

[HTTP://WWW.STATE.CO.US/CFMA/HOME  
.HTM](http://www.state.co.us/cfma/home.htm)

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## Special Insert:

*Show Me the Money &  
What's the Risk?*



## President's Corner *Tom Kingsolver*

We have finalized the CFMA speakers for the spring conference. We will have speakers presenting on SAS 109 and how it will affect you from an audit perspective, Sarbanes Oxley and how governments may be impacted, hiring and retention in today's multi-generational workforce, how to perform an in house risk assessment, fraud and forensic accounting, pollution remediation accounting under GASB 49, contracts/fiscal rules, higher Ed capital financing opportunities, higher Ed tax issues and a PERA update. We have been able to obtain a wide variety of

knowledgeable speakers from within the state, the private sector and partners/principals from local and national CPA firms.

CIMA has added a third track this year that will be devoted to IT security. Key note speakers so far include Margie Seyfer on improving your people skills, Governor Ritter, and the State CIO, Mike Locatis. The spring planning committee is still working on finding a closing keynote speaker.

In last month's newsletter I suggested considering using college students for

internships in place of hiring vendor temporary workers. Since then, the Taxpayer Service Division here at Revenue is in the process of working with Metropolitan State College to find interns for this tax season. If this is something you would like to know more about, you may contact Melinda Brenimer, internship coordinator at Metropolitan State College. She may be reached at 303-556-3290 or by e-mail at [brenimem@mscd.edu](mailto:brenimem@mscd.edu). This would be a nice opportunity to get to know some future accounting graduates to fill those soon to be openings we will all have.

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## Top Ten

*Bill Schlaufman*

There's been a lot of talk about ballot initiatives and new taxes to fund various programs throughout the state. Here are some of my ideas to increase revenue for the State.

Top ten ways to increase revenue for the state:  
10. Texan Gas Tax. Additional gas tax of \$1 per gallon for anyone with Texas license plates.  
9. Supplemental Amortization Equalization Disbursement. Take funds from raises to State Employees and transfer to make retirement fund solvent. Oh, never mind, that was already done.

8. Ballot Initiative Tax. Anyone putting a proposal on the state ballot that restricts money to certain programs or sends refunds back to taxpayers must pay \$100 million out of their own pocket to fund the administrative costs of compliance with the initiative before putting the measure on the ballot.  
7. Former Politician Employment Tax. Any former politician that is hired by the state must pay a 75% payroll deduction tax to compensate for the damage that they will inevitably cause.  
6. Non Smoking Tax. Tax all non-smokers an additional \$1000 per year on their income tax.

Create new cigarette kiosks around the state to encourage smoking. This will increase the mortality rate, thereby reducing future health care and social security costs.  
5. Gambling Tax. Replace all slot machines in Central City, Black Hawk and Cripple Creek with special "Tax Slot Machines" that never pay off, only collect "tax" money for the state.  
4. Department of Revenue Embezzlement Initiative. Send accused embezzler from Department of Revenue to neighboring states to embezzle money from them and send the funds to the State of Colorado.

*...continued on page two*

## President's Corner *continued from page one*

As you know my President's letters have continually talked about succession planning as we baby boomers reach retirement age. Leading the charge most recently for CFMA is Dottie Relaford from the State Controller's Office (who has been CFMA's web master and in charge of luncheon reservations for years) and past CFMA President Mindy Densmore from Revenue. Dottie retired in January and Mindy will be retiring in March. Both Dottie and Mindy have been very active CFMA members and they will be missed.

I am happy to announce that the new mentoring program created by Anne Bygrave at Education has its first two mentoring matches. Mary Ball, an accountant at Human Services has been paired with Tammy Nelson from the State Controller's Office and Insook Bhushan, an accountant with Military Affairs has been paired with Don Reick from the Department of Health. We still have openings for anyone who would like to be paired with a mentor. Contact Anne Bygrave if you are interested by e-mailing her at [Bygrave\\_A@cde.state.co.us](mailto:Bygrave_A@cde.state.co.us) or see the "Mentoring" page on the web site.

Be sure to get your reservations in for the February luncheon at the Beef Palace. Our speaker will be Heather Kopp, CFO for the Department of Transportation. Heather will be talking about the Department of Transportation from the funding and financial perspective. **For the February luncheon you must e-mail Kelli Cheshire your luncheon reservation due to some problems with our web site.** [kelli.cheshire@dora.state.co.us](mailto:kelli.cheshire@dora.state.co.us)

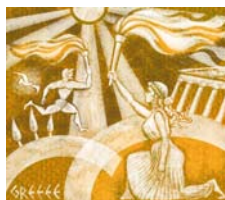
As of January 28<sup>th</sup>, more than half of the rooms for the spring conference at the Cheyenne Mountain Resort (CMR) have been reserved. If you have not yet reserved your room by the time you read this it could already be too late. Call CMR at 800-428-8886 to reserve your room. Be sure to tell them you are registering for the CFMA conference. If you prefer, you can now register on line here [CFMA/CIMA/CSMA at Cheyenne Mountain Resort](#). We will be sending out information on nearby hotels in case you are not able to reserve a room at CMR.



## Top Ten *continued from page one*

*Bill Schlaufman*

3. High Stakes Gambling Initiative. Send MIT graduate who is an expert in counting cards to Las Vegas with all of state's money so he/she can double it at blackjack tables.
2. Pay Date Shift Version 2. Double all accountants' salaries for this fiscal year, but for budget purposes count against year 2099 budget. We all know you must account for all expenses using generally accepted accounting principles, but for budget purposes, you can do whatever you want.
1. Kicking Legislator Tax. Tax any legislator that kicks a photographer from a newspaper 100% of their salary and prohibit them from proposing any ballot initiatives. Also fine them \$1000 for each time they compare themselves to Jimmy Stewart.



# Bean Counter's Underground Press

*Alan Boisvert*

As an accountant I have always viewed money as something that needs to be tallied and balanced. I have always admired actuaries and budget analysts because their view of money has always been forward looking, not historical as my view is, which is doing the CAFR six months after the fiscal year-end. Thus, I simply reported on the results, not to be confused with helping to facilitate the results.

Since I use to be married to a banker, I learned that bankers did not really understand money, or at the minimum how to make it, even though that was their business. In good times, they made good loans and bad loans. In bad times they made no loans. Thus, bankers were the cause of all recessions. They over-lend in the good times, and refused to lend even to worthy borrowers in the bad times. Thus, they were the cause of the contraction of the business cycle.

Finance majors were a breed apart. They really understood money. They knew where it was, how to get it to where it needed to go, and how to profit from the transaction. They weren't just bankers, heck no, they were investment bankers. Oh yeah, after the market collapse of 1929, and the Democrats taking control in 1933, the first act of Congress was the Glass-Steagall Act, separating banking from investing, which corrected the excesses that lead to the Great Depression.

We still knew those finance majors were geniuses though. Oh sure we had the S&L crisis caused by the

increase in FDIC insurance to \$100,000 and allowing developers to buy up Savings & Loan companies to finance their construction euphoria. That was a simple mistake of policy, which was not systemic and would never happen again. Who would ever borrow short and loan long again. Jimmy Stewart perhaps in "It's A Wonderful Life," but not a Harvard MBA with a finance emphasis.

Then the collapse of LTM in 1998, in which the finance geniuses could hedge any bet on the developing markets, even if Russia defaulted on its debts, it would not bring down the markets because those finance geniuses at the Federal Reserve could put together a rescue package. After all, LTM was just a bunch of trades that had to be unwound over time and Wall Street was quite familiar with those trades. They could easily assist the Federal Reserve to buy that time as long as there was money to be made.

Then surpluses created during the Clinton years eliminated the need for 30 year Treasury Bonds, so President Clinton ceased the issuing of such long-term debt. Now the U.S. could no longer go long, and simultaneously depreciate the currency. Thus, the U.S. could not renege on its debt by debasing the currency because it had to borrowed short-term just like the rest of us, and would be subject to the same market fluctuations.

Then the Republicans took control again and it was decided that the constraints of the Glass-Steagall Act were no

longer necessary and we needed to unleash the power of Wall Street, to merge banks and brokers back together as investment bankers. We could lift all Americans to a new level of financial security, maybe even give them private social security accounts that they could invest themselves in Wall Street.

Now those geniuses in finance lead us on a dot.com boom that collapsed when we realized that even if every book in the world was sold by Amazon.com it couldn't really justify the price to earnings ratio. So the finance geniuses at the Fed brought the Fed Funds rate down to 1.0% to help the economy. Since PERA lost so much money in the stock market it was decided that they needed to invest more in fixed income securities, especially ones that would yield about 7.5% and had a 30 year maturity, same as your retired life span.

With the Fed Funds at 1.0% and no 30 year Treasury bonds available where oh where would PERA find such an instrument? Alas, Wall Street could create just the thing that PERA, needed, a CMO, or Collateralized Mortgage Obligation. Just take a bunch of less than worthy mortgages, group them into bundles of \$10,000,000 or so, bundle them up with some auto loans and credit card debt into CDOs, Collateralized Debt Obligations of, say \$100,000,000 or so, slice them into tranches, get Moodys and S&P to rate the tranches, then sell the AAAs to PERA. The Mezzanine tranche to PNB Paribas, the toxic waste to a hedge fund, and whammo, everybody is

happy.

Works for me, as long as house prices are rising. Historically, rents have been between 5.5 and 7% of house prices. However, with the Fed Funds at 1.0% then mortgages were at 40 year lows, rents were down to 3.5% of house prices. Not because rents fell, but because housing was the new dot.com. And with the demand for higher interest 30 year instruments going through the roof, the only choice was fraud, speculation, and greed. Definitely, the makings of a sub-prime mortgage collapse.

The finance PhDs at the Federal Reserve have taken note and began another round of Fed Funds rate cuts to stem off the recession, caused by the housing bubble collapse which, by the way, they caused by holding interest rates too low for too long. Thus, we enter a Reverse Minsky Journey which follows a Minsky moment, which is what we had in August of 2007. Hyman Minsky, who died in 1996, was an economist who determined that periods of high stability sow the seeds for periods of high volatility, due to under estimating risk, and vice versus. So the decade we just went through of low inflation, low interest rates, and ever bigger SUVs, is to be followed by a decade of, well, just the opposite.

Times have changed and you have to take what the market gives you. On Martin Luther King Day, I went to work for a few hours to do two things, one, to prepare for an 8:30 meeting on Tuesday that I wasn't prepared for, and to work out on the new rowing machine that

...continued on page four



## Bean Counter's Underground Press *continued from page three*

Jefferson County bought just for me and 2900 other people because I whined so much that we needed one. What I noticed on my computer screen was that the stock markets all around the world were collapsing in what seemed to be a panic sell-off that appeared to be unexplainable.

Some background is in order. PERA made 9 percent last year even losing \$300,000,000 in the fourth quarter. I am proud to say that I made 12.7 percent through September 30, then lost half my gain in the fourth quarter to average 6.3 percent for the year. This was much worse than PERA, but this expensive lesson taught me that you have to take what the market gives you, and what it was giving was volatility. So beginning in January 2008, I switched to short-term trading.

Since the markets were closed for MLK there was nothing I could do but watch. The sell orders piled in and the futures predicted a 400 point sell-off in the Dow. On Tuesday, all the traders came back to work in New York, got their coffee and ask each other what was going on, but no one knew. Then the Fed announced a 75 basis point emergency cut in the Fed Funds rate. I had an 8:30 meeting, mentioned in the previous paragraph, and didn't know what was happening. So I looked quickly in the trash bin and there was Wells Fargo, taken to the woodshed and beaten to a pulp. It was down to \$26.50. I said, "That's a \$35 stock, what in all jimmyny is going on here"?

So I bought WFC and went to my meeting. Two days later I sold Wells Fargo at \$32.00, enough profit in two days to make my mortgage and truck payment for the month. Thus, I was adequately able to supplement my measly government paycheck.

Since MLK, we have learned that some French guy sitting at the Delta One table at Society General, the second largest bank in France, lost \$7.2 billion for the bank by doing unauthorized trades. What we know is that SocGen spent all weekend before MLK trying to figure out what they owned and what they needed to unwind on MLK day. They must have sold off \$50 billion or more that day and precipitated a world-wide panic. However, they took their good old time in informing the Bank of France, which took its dear time in informing the ECB, which took lots of time in informing the Federal Reserve. Thus, in my mind the Fed acted irrationally, because it lacked knowledge of the facts and the cause when it made its move.

We all knew that the FOMC was meeting on January 30<sup>th</sup> to determine what the future Fed Funds rate would be and the consensus of my office was that they would cut 25 basis points, given that they had cut 75 basis points the week before. The futures market had wagered 70 percent on a 50 basis point cut. I thought the Fed would cut 25 points and I shorted the Dow on Monday thinking the market would be disappointed. I had to

would cut 25 points and I shorted the Dow on Monday thinking the market would be disappointed. I had to spend Monday watching the DOW gain 98 points as it was pricing in a 50 point cut. Thus, I panicked and hedged by buying a materials index and an S&P index, assuming that if the Fed cut 50 points, the inflation hawks would drive the materials index and the financials up.

Although my moves were contradictory they followed two divergent thoughts. The first is that the primary responsibility of the Fed is to defend the currency. We have seen the Fed cut rates even though inflation is above their comfort zone. We saw the G20 chastise the U.S., Japan, and China for depreciating their currencies. The Canadians are upset and the Europeans are beside themselves because their currencies and economies have suffered because the dollar, yen, and yuan have declined vis-à-vis the Euro and the Canadian dollar (see Honda's earnings report and where those earnings came from). Thus, the panic cut of 75 basis points on January 22nd was enough, and the Fed would get no help from the ECB.

But my second line of thought was that Bernanke had gone before Congress and said yes to the stimulus package. Bernanke's PhD came from studying the Great Depression and how Hoover's government did everything wrong by fighting inflation instead of fighting recession. So, going into the FOMC

meeting, I couldn't tell whether the man's pride or his political instincts would dominate. So I hedged my bet.

As Ron Hinton always said, "I'd rather be lucky than smart". I was working out on the rowing machine at 12:15 MST when the Fed announced their 50 point cut in the Fed Funds and the discount rate. The Dow took off and my short position began to cost me some serious money. I showered and trekked off for the 1:30 meeting between the Library Trustees and Board of County Commissioners. However, when I returned to my office long after the market had closed, to my surprise the Dow was down 37 points for the day, as Fitch had down graded the bond insurer FGIC, totally countering the Fed's action.

The next day I unwound my shorts on the Dow with just some minor losses, added to my materials position, and bought back Wells Fargo at \$33. I had a very good January financially, but another big disappointment for me with the people in charge. Lesson learned, and my advice to you: "Don't let you children grow up to be cowboys, make them grow up to be commodities traders in a global market". And, PERA is the best thing that ever happened to State employees. After all, 9 percent beats a poke in the eye. By the way, PERA, State Division, will be fully funded again in 2060. Your retirement is secure, but only if you are paid in Euros.

*"The opinions expressed here in are those of the author and do not necessarily represent the opinion of the Colorado Fiscal Manager's Association, its board, or its members."*





# Controller's Corner



## What's Happening?

### OSC Retirement

We just wanted to say "Thank You" to all those who made it to Dottie Relaford's retirement party on January 31st. To all those who couldn't make it - you missed a very nice get together!

*FYI*- we heard from Dottie a few days after her retirement, on one of those snowy days, and she said that she woke up at 8am and laughed because she didn't have to go anywhere!!! ☺

### **CCCAS Turnaround Forms**

Prior to Dottie's leaving, she sent out all of the Continuing Capital Construction Appropriation Status (CCCAS) forms. When completing the forms, we ask that you please do not change or delete information on the form. Instructions for completing the form are in the Fiscal Procedures Manual, Chapter 4, Section 1.18.

*By the Field Accounting Services Team, State Controller's Office*

### Fiscal Procedures Manual

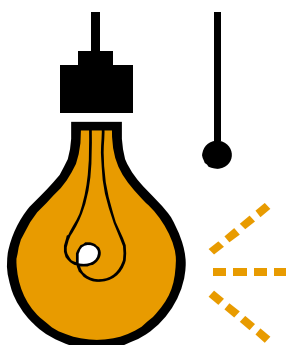
As a reminder, please verify ALL of your agency's contact information for the Fiscal contact and the Department/Institution head. Links for what is currently listed and to make changes are located at <http://www.colorado.gov/dpa/dfp/sco/contacts/fiscalcontacts.htm>

### NASC Conference

The National Association of State Comptroller's Conference will be held in Denver on March 12-14, 2008. The conference will be located at the Adams Mark hotel on the 16<sup>th</sup> Street mall. Those who have attended this event in the past, say that it provides a wealth of information, as well as good networking with other accounting types in other states.

There will be panels addressing finance transformation, managing change, benchmarking and reaping its results, a GASB update, reflections on year one of SAS No. 112, and several ERP topics, including preparing for ERP and executive decision-making related to an ERP implementation. Three sessions of the comptrollers' roundtable will allow for plenty of interactive discussion about a wide variety of topics and challenges in the world of financial management in state government. Fifty-minute segments of the roundtable will be dedicated to each of two topics: OPEB and Oregon's XBRL project. To register, see the agenda, or for more information go to <http://www.nasact.org/conferences/events.cfm>

## From the "Thought You Should Know" Category



***A one-year patch to the Alternative Minimum Tax (AMT)***- As the AMT was set to capture approximately 21 million more American taxpayers, Congress passed a \$50 billion "patch" for the 2007 tax year to prevent it from doing so. The patch, however, does not apply to 2008, so the AMT issue will be revisited again very soon.

***GAO Issues Government Auditing Standards Implementation Tool***- The U.S. Government Accountability Office has issued a guidance document, Government Auditing Standards: Implementation Tool-Professional Requirements Tool

for Use in Implementing Requirements Identified by "Must" and "Should" in the July 2007 Revision of Government Auditing Standards. This professional requirements tool lists the requirements for audit organizations and auditors included in the July 2007 revision of generally accepted government auditing standards (GAGAS), also commonly known as the Yellow Book.

As described in the July 2007 revision, GAGAS uses two categories of professional requirements, identified by "must" and "should," to describe the degree of responsibility they impose on auditors and audit organizations. The professional requirements tool contains general requirements for audit organizations,

and specific requirements for financial audits, attestation engagements, and performance audits. The general requirements section contains entity-wide requirements for the audit organization and is intended for use in addition to the specific sections for financial audits, attestation engagements, and performance audits, which contain engagement-specific requirements for the auditors conducting the engagement. This tool does not include explanatory material from the July 2007 revision of Government Auditing Standards. Audit organizations and auditors should read the entire text of the July 2007 revision of Government Auditing Standards, including the explanatory material when



## Controller's Corner continued from page five

planning the audit and making professional judgments about compliance with professional requirements. The new guidance document and the July 2007 revision should be used in conjunction with the following additional guidance documents, which are all available on the Yellow Book Web page at <http://www.gao.gov/govaud/ybk01.htm>:

\* *Government Auditing Standards: Answers to Independence Questions* (GAO-02-870G, July 2002)

\* *Government Auditing Standards: Guidance on GAGAS Requirements for Continuing Professional Education* (GAO-05-568G, April 2005)  
by GAO's government

facilitate audit organizations' and auditors' implementation of the standards, and does not represent additional standards or requirements. The tool may be downloaded from GAO's Web site at [www.gao.gov/govaud/ybk01.htm](http://www.gao.gov/govaud/ybk01.htm)

**Department of Homeland Security Issues Final REAL ID Regulations-** With just 120 days before the implementation deadline, the U.S. Department of Homeland Security issued the final REAL ID regulations on January 11. According to the National Governors Association, the National Conference of State implementation cost was an issue by making changes to reduce costs to states. The

estimated cost remains significant at \$3.9 billion. To date, however, Congress has

appropriated less than three percent of the projected costs to assist states. *To view the final regulations, visit [www.dhs.gov/xprevprot/laws/gc\\_1172765386179.shtm](http://www.dhs.gov/xprevprot/laws/gc_1172765386179.shtm)*



**"Live as if you were going to die tomorrow.  
Learn as if you were going to live forever."  
~ M.K. Gandhi**



### CFMA SPRING CONFERENCE

**SPACE IS  
LIMITED SO  
REGISTER  
TODAY!!**

### 2008 SPRING CONFERENCE

\*\*\* \*\*

**APRIL 16, 17, & 18**

**CHEYENNE  
MOUNTAIN  
RESORT**

**COLORADO  
SPRINGS,  
COLORADO**

Keynote speaker on Thursday, April 17th will be Governor Bill Ritter

Conference fee will be \$100 (\$125 for late registration).

Go to <http://www.state.co.us/cfma/Seminars/seminars.htm> for more information



# The Fourth Branch

## Happenings in Higher Education



### CFMA Spring Conference and Higher Education Controllers Meeting

The Financial Advisory Committee (FAC) would like to encourage each institution to attend the Spring CFMA Conference scheduled for April 16-18<sup>th</sup> in Colorado Springs at the Cheyenne Mountain Resort. We hope to have on-line registration available by the week of February 18 via the CFMA website. A higher education track will be provided including training sessions on GASB 49 (Pollution Remediation Obligations), Higher Education Tax Issues, Debt Issuance, Fiscal Rules/Policies regarding contracts, Fraud/Forensic Accounting and Risk Assessment. Please see the CFMA web site for more information.

There will be a Higher Education Controllers meeting immediately preceding the conference on April 16, from 10:00-12:00. We hope to have updates from the OSC, OSA and DHE (previously known as CCHE). The Higher Education Policy Setting group will provide new updates to the COFRS COA and FAC website. Lunch will be provided, so make sure you sign up when registering for the conference.

### Save the Date! Higher Education Open/Close

This year we will have **TWO** Higher Education Open/Close Meetings. The first will be on May 8<sup>th</sup> in Denver. The second meeting will be on May 15<sup>th</sup> at Adams State College in Alamosa. Video conferencing will only be available during the May 8<sup>th</sup> meeting. We are still working on the exact locations and times and will provide updates as they are available.

Please contact your FAC representative or Vicki Nichol at [Vicki.Nichol@cudenver.edu](mailto:Vicki.Nichol@cudenver.edu) if you have any questions.



## CFMA LUNCHEON DATES/LOCALE

We are still confirming dates for the remainder of the year. See the web site for more info.

Mar. 20, 2008 TBA  
Apr. 17, 2008 TBA  
May 22, 2008 TBA  
Jun. 19, 2008 TBA

Here is a list of the luncheon dates; speakers will be added as they are confirmed. Most luncheons are on Thursday except for Nov. 28 and Feb. 20, which are Wednesdays. The location will continue at the Beef Palace except for January 17, 2008 which will be held at the Historical Society.

Oct. 17, 2007 Cherry Mallard  
Nov. 28, 2007 Dylan Ikenouye  
Jan. 17, 2008 TBA  
Feb. 20, 2008 Heather Copp

Your lunch reservations should still be made using the Internet. Visit the CFMA luncheons web page (see link below) and click on the "Place Setting." You can register each month or sign up for all the lunches in one visit.



### FEBRUARY LUNCHEON

**Place:** Beef Palace – Serving Mexican Buffet

**Time:** February 21, 2008, 11:45am -1:30pm

**Speaker:** Heather Copp, CFO – CDOT

Please register by **12 PM on MONDAY, FEBRUARY 18<sup>TH</sup>**. If you need to cancel after you register, please email Kelli Cheshire before noon on the Wednesday before the lunch

[kelli.cheshire@dora.state.co.us](mailto:kelli.cheshire@dora.state.co.us)

<http://www.state.co.us/cfma/Luncheons/lunch.htm>

## About Our Organization

CFMA is run by state employees elected by the membership. The Executive Board consists of the following four elected executive officers: President, Vice-President, Secretary, and Treasurer. Per CFMA's by-laws, all the officers are

elected for a one year term. The President and Vice-President can not succeed themselves in the same office. The Secretary and Treasurer can succeed themselves in office, but can serve no more than two consecutive terms.

At the discretion of the Executive Board, committees can be formed to assist in carrying out CFMA's goals and objectives. Participation on these committees comes from active CFMA members.

"Attend three CFMA luncheons this year and get the 4<sup>th</sup> lunch free!" – CFMA Board

CFMA's very popular buy three get one free lunch program is in place for the upcoming year. If you attend all eight lunches this year, CFMA will pay for two of them. To assist in the record Keeping process, please register each month using the Web site registration and be sure to use the same name. For example, Roger Cusworth and Roger A Cusworth are treated as two people in the database used to track free lunches. You also need to be sure you check in each time you attend a luncheon.

In case you are wondering, your attendance from last year does not carry over to this year.



### We're on the Web!

See us at:

<http://www.state.co.us/cfma/home.htm>





# Show Me The Money . . .

## or how to save it when your auditors apply the new audit risk standards

By James M. Boak, CPA

As most may recall, two new standards were issued last year that affected the timing of the 2006 audit opinion issuance date, engagement completion, and the content of the 2006 management letters. Eight additional auditing standards have been issued subsequently that affect all 2007 calendar year engagements and after. To understand the impact of the new standards on audit firms, please see the article "*What's the Risk? The New Risk Suite of Auditing Standards*," on page 30. The new standards add procedures to the audit of every nonpublic entity: private, non-profit, governmental and employee benefit plans. Entities with limited budgets should begin planning now if they wish to minimize potential audit cost increases.

### First, what can you as the audited entity expect from your audit firm?

- Auditors will feel pressure to increase fees to accommodate their increased hours for completion of your audit engagement. That increase has been estimated to range from 15% to 35%.
- Auditors are likely to have a learning curve in the first year's implementation of the new auditing standards due to their extensiveness and complexity.
- Auditors likely will extend the amount of time spent on fieldwork in your office, both before and during the audit fieldwork, to perform the additional analysis and required testing.
- Your auditor will request the preparation of additional work papers by your personnel, especially in the area of internal controls. This will assist them in understanding and verifying implementation of your internal controls.
- Verbal responses to auditor inquiries that may have been sufficient in the past now must be supported with additional evidence from your records.

### What can you do to mitigate these potential audit hours and cost increases?

- Meet with your auditors to determine what **additional documentation and records** they may require and begin working on this information after your meeting.
- Arrange for the auditors to perform **timely interim testing** to avoid overburdening the time frame for regular, year-end fieldwork.
- Use the prior year management letter to **understand your weaknesses** in internal control.
- Complete a **self-assessment of inherent and control risks and financial assertions** associated with each account group.
- Document **accounting flow, processes, and specific key controls** in each area. Identifying key controls may require assistance from your auditors.
- Understand the core concepts of entity-wide **Council of Sponsoring Organizations (COSO) controls**, especially as they apply to your operations as well as to your accounting function.

- Document COSO controls details applicable to your entity including **control environment, business and accounting risk assessment process, communication of control goals and policies**, and monitoring efforts. Be prepared to provide and show the auditors support for each of these controls.
- Document and be prepared to discuss your **IT general and application controls**. The auditors may ask to inspect the operation of such controls.
- At the end of the audit, be prepared to receive a list of **unrecorded adjustments and potential adjustments** derived from sampling errors or estimates differences. These may be material misstatements, and you will be asked to try to resolve these matters and provide additional evidence for your position.

### What other general concepts should I understand?

- Increases in costs to you can be mitigated in part wherever your personnel can adequately **prepare detailed analyses and memos of the key areas of your internal controls**. Internal controls now include

*Continued on next page . . .*

### FASB Defers FIN 48 for Non-public Companies

On November 7, the Financial Accounting Standards Board (FASB) agreed to defer the effective date of **FASB Interpretation (FIN) No. 48, Accounting for Uncertainty in Income Taxes**, for non-public companies. FIN 48 was issued in July 2006, and had an original effective date for years beginning after December 15, 2006 (2007 for most non-public entities). The FASB approved a one-year deferral until periods beginning after December 15, 2007, for non-public companies. This deferral does not apply to those non-public companies that already have adopted FIN 48.

In considering the deferral, the FASB cited complications associated with "pass-through" entities, for example, S corporations, as well as other concerns that the AICPA's Private Company Financial Reporting Committee had identified.

The formal deferral extension will be set forth in a FASB Staff Position issued in exposure form for a 30-day period.

## Show Me the Money . . . *Continued from previous page*

preparation of financial statements and related footnotes. Thus, the more documentation you have or can provide to auditors relating to your internal controls (not just accounting flow and processes), the easier and less time-consuming the additional procedures will be.

- Remember to **insist on a pre-engagement conference** to discuss the nature and extent of documentation assistance that you and your personnel can provide. Obtaining copies of auditor checklists beforehand would better prepare you for this planning conference. Auditors likely will rely heavily on the use of these checklists and memos. Your preparation of many parts of these checklists may reduce the auditors' time related to the new standards. With this assistance, entities will enable auditors to focus their time on the testing elements of accounting systems and the general ledger rather than on development of documentation of the systems. Plan to receive these checklists early enough to allow enough time to understand and complete the requested documentation.

- Many concepts are technical, subtle, and complex. Many of the internal control concepts may not be intuitively understandable if you do not have prior auditor experience. **Receiving the checklists on controls or similar information requests early** can help you decide if your staff has the skills or time to prepare such documentation. You may wish to hire a consultant, and you should coordinate such action with your auditors.
- Above all, **be ready for the auditors' arrival**. Insure your records are organized and immediately accessible. Try to avoid completion of requested information after the auditors arrive and begin performing fieldwork. Reserve maximum time for the fieldwork phase to work with the auditors, especially in the first year of the implementation of the new audit standards.

By working together with your auditors, you can control the additional costs associated with these new audit risk standards and gain a stronger, more interactive relationship.▲

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# What's the Risk?

## the new risk suite of auditing standards for 2007 calendar year audits

CPAs who perform audits of non-public entities are generally aware of the newly applicable **Statements of Auditing Standards (SAS) Nos. 104 to 111**. However, many practitioners have not yet had time to study and gauge the impact of the new standards on their audit procedures. This article summarizes many of the new requirements and highlights a few of the critical changes from the prior standards.

As an indication of the new standards' complexity, the eight standards are about 100 pages long, and the related AICPA audit guide is 250 pages long. Much of the focus is on planning and analyzing the risk of material misstatement in the context of a client's internal control system. These new risk standards will change or enhance many auditing standards and practices that have been dominant in the last 20 years.

The following list provides specific examples of procedures required by the new audit standards:

- The new standards apply to audits of every non-public entity, including private companies, nonprofits, governmental units, and employee benefit plans for years beginning or after December 15, 2007, i.e. calendar years 2007 and after.
- There are numerous terminology changes that have been in common use, e.g. audit "plan" replaces audit "program."
- The concept of materiality is expanded to include quantitative and qualitative considerations as perceived by the financial statement users (versus the auditor).
- Risk assessments must occur at the account level as well as at the entity-wide level.
- In the context of risk impact, documentation is required on why relevant financial statement assertions are risks for general ledger account areas. Traditional financial assertions are expanded from five to six with the addition of the cut-off assertion.
- At the entity-wide risk level, the five general Council of Sponsoring Organizations (COSO) control components must be analyzed: control environment, risk analysis, communication, control activities, and monitoring.
- Auditors must incorporate an analysis of general and application controls related to IT accounting applications.
- Auditors must document an overall audit strategy.
- Formerly recommended elements, such as tolerable misstatement and engagement letters, are now mandatory.
- All written audit plans (formerly audit programs) must specifically be tailored to include the 1) nature, 2) timing, and 3) extent of procedures. Such plans are required for both A) the risk assessment work in the planning process and B) the further (substantive) audit procedures to be performed during fieldwork.
- In the risk assessment phase, auditors must gather and verify information on the design and implementation of internal controls at the general ledger account level to properly assess audit risks.
- Verification of design and implementation of internal controls may include inquiry procedures but also must include at least one of the following additional procedures: 1) analytics, 2) observation of client procedures, and/or 3) inspection of documents.
- The planning "brainstorming" session is expanded from SAS 99 fraud matters to include such items as discussion of internal controls, audit strategy, and all areas of potential material misstatement.
- Once the risk assessment phase is completed, auditors must evaluate ("understand") the risk assessment impact on the audit plan and subsequent substantive fieldwork procedures.
- To demonstrate that understanding, auditors must document ("link") audit areas, financial assertions, and risks of material misstatements to specific, planned, substantive audit procedures.
- Journal entry procedures have been expanded. Material adjusting journal entries must be examined (in addition to SAS 99 tests).
- Misstatements accumulation and analysis must include "exposure" errors from extrapolated sampling results and estimates errors. This is in addition to financial impact of known, unadjusted errors.
- Furthermore, the "exposure errors" accumulated in the misstatements analysis must be submitted to management for affirmation or rebuttal. Rebuttal includes additional evidence supporting the position.
- At the conclusion of the audit, auditors must document support for the financial statement amounts in the underlying company financial records, presumably through the trial balance "tie out" process.

Auditors can expect that the most time-consuming part of these new procedures will occur in the documentation of internal controls and verification (including documentation) of implementation of specific account and general, entity-wide controls. Documenting the "linking" process also can

be time-consuming. Aside from potentially increased hours, there are many subtle changes from prior standards that auditors should be aware of:

- Documentation, in effect, must include ‘why’ the auditor performs various procedures and not just ‘what’ procedures the auditor has performed.
- Audits must be an “iterative” process which means there always will be a possible need to redo and re-document earlier planning procedures based on evidence discovered later in the audit process.
- The SAS 55 concept of “defaulting” to maximum control risk is not permitted. Control risk at any level must be supported by evidence.
- Reliance on inquiry alone as an evidence-gathering procedure is unacceptable in major risk areas.
- Spreadsheets prepared by clients or staff often lack controls and are prone to error. Auditors should have procedures to counter this risk.
- Performing risk assessment procedures may be accomplished most easily by applying traditional “walkthrough” audit procedures.
- The use of “canned” audit programs for various account areas is not permitted unless they are specifically tailored to the client. This is because each client is likely to have different risks.
- The procedures discussed here, as well as others not mentioned, likely will require more time on the auditors’ part to complete inquiries and testing, as well as to complete internal documentation within checklists, memos, and work papers on each audit engagement. A memo approach to documentation is permitted though many auditors will find a checklist-driven process to be more practical.
- The standards likely will extend the amount of time spent on fieldwork in the client’s office. Where possible, auditors may wish to do this as interim work outside the traditional timing of specific year-end audit procedures.

Many clients have accounting staff who are experienced in documenting and analyzing internal controls and drafting financial statements and footnotes. However, in circumstances where the client accounting personnel may be unable to complete these tasks, auditors will have to do so themselves in order to accumulate adequate audit evidence to issue an audit opinion.

The standards themselves are most easily understood by reviewing the AICPA **Audit and Accounting Guide, Assessing and Responding to Risks in a Financial Statement Audit**. Additionally, private vendor auditing guides also provide good overview and detail plus practice aids and checklists to guide the auditor through implementation. Training will be critical as well as study of revised audit checklists and practice aids to become familiar with the changes and increased testing and documentation requirements. The ‘silver lining’ to this challenge will be the opportunity to strengthen the interactive relationship between CPA firms and their clients.▲

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